

Service Date: December 18, 2000

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

IN THE MATTER OF the	)	UTILITY DIVISION
Implementation of 47 C.F.R. § 51.507(f),	)	
Establishing Different Rates for Network Elements	)	DOCKET NO. D99.12.277
in Different Geographic Areas Within the State	)	ORDER NO. 6227b

IN THE MATTER OF The Petition of	)	UTILITY DIVISION
AT&T Communications of the Mountain	)	
States, Inc. Pursuant to 47 U.S.C. Section	)	DOCKET NO. D96.11.200
252(b) for Arbitration of Rates, Terms,	)	ORDER NO. 5961j
and Conditions of Interconnection with	)	
Qwest Corporation,	)	
f/k/a U S WEST Communications, Inc.	)	

**FINAL ORDER**

Appearances

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BEFORE:

Dave Fisher, PSC Chairman  
Nancy McCaffree, PSC Vice Chair  
Bob Anderson, PSC Commissioner  
Gary Feland, PSC Commissioner  
Bob Rowe, PSC Commissioner

### Introduction and Background

In August of 1996 the Federal Communications Commission (FCC) adopted the following rule: "State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences." 47 C.F.R. § 51.507(f). (Sometimes referred to as the "deaveraging" rule.) In September of 1996 this rule, along with other FCC "pricing" rules adopted to implement 47 U.S.C. § 251 of the federal Telecommunications Act of 1996 (Telecommunication Act, or Act), was stayed by the United States Court of Appeals for the Eighth Circuit (Eighth Circuit) pending that court's consideration of a challenge to the pricing rules. In July of 1997 the Eighth Circuit vacated the deaveraging rule, but in January of 1999 the United States Supreme Court reversed the Eighth Circuit, reinstating the 47 C.F.R. § 51.507(f), deaveraging rule requirement on state commissions.

On May 7, 1999 the FCC stayed the effectiveness of the deaveraging rule until six months after it issued a final order on implementation of high-cost universal service support for non-rural LECs. FCC Stay Order, CC Docket No. 96-98, May 7, 1999. That order, Ninth Report and Order and Eighteenth Order on Reconsideration, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, was issued on November 2, 1999. Therein the FCC stated:

Now that we have adopted an order in CC Docket No. 96-45 finalizing and ordering implementation of intrastate high-cost universal service support for non-rural LECs, state commissions can consider deaveraging in concert with the federal high-cost support that will be available in the intrastate jurisdiction. Consequently, the stay that has been in effect since May 7, 1999, shall be lifted on May 1, 2000. By that date, states are required to establish different rates for interconnection and UNEs in at least three geographic areas pursuant to section 51.507(f) of the Commission's rules.

Id. at paragraph 120.

Given that the requirements of the FCC deaveraging rule would become effective on May 1, 2000 the Montana Public Service Commission (Commission), on December 21, 1999, opened Docket No. D99.12.277, In the Matter of the Implementation of 47 C.F.R. § 51.507(f), Establishing Different Rates for Network Elements in Different Geographic Areas Within the State, and issued Notice Directing Filings, Notice of Party

Status, Notice of Opportunity to Intervene and Proposed Procedural Schedule (Notice). In the Notice the Commission described the requirements of the deaveraging rule, 47 C.F.R. § 51.507(f), and noted its May 1, 2000 effective date. The Commission also noted that the requirements of the deaveraging rule are qualified by Montana law, and stated that § 69-3-848(3), MCA, and 47 C.F.R. § 51.507(f) "must be harmonized." The Commission directed Qwest Corporation, formerly known as U S WEST Communications, Inc. (Qwest), "to make a filing that will allow the Commission to comply with 47 C.F.R. § 51.507(f), while remaining consistent with § 69-3-848(3), MCA." The Commission also directed Qwest to make a filing "that deaverages network element prices in any interconnection agreement that is covered by § 69-3-848(4), MCA."

In response to an invitation in the Notice to comment on the proposed procedural schedule, Qwest submitted instead legal and policy argument. As a result the Commission gave the other parties an opportunity to respond. After reviewing all comments and responses the Commission, on February 1, 2000, issued an Amended Notice Directing Filings, Amended Notice of Party Status, and Procedural Order (Amended Notice).

In the Amended Notice the Commission found as follows: 1) The December 21, 1999 Notice applies only to Qwest because Qwest is the only non-rural telephone company in Montana; 2) The only parties to a proceeding that deaverages network element prices in the Qwest/AT&T interconnection agreement should be Qwest, AT&T and the Montana Consumer Counsel; 3) The Commission will not consider Montana law preempted "unless a proper court so determines, or there is absolutely no good faith argument to support Montana law[.]" and, therefore, the Commission "will comply with 47 C.F.R. § 51.507(f), as far as possible, consistent with § 69-3-848[, MCA]"; 4) The "line sharing" issue would not be addressed in Docket No. D99.12.277, but will be considered in a subsequent docket. As a result of these findings the Commission directed in the Amended Notice that Docket No. D99.12.277 covers "Qwest's filing to allow the Commission to comply with 47 C.F.R. § 51.507(f), while remaining consistent with § 69-3-848(3), MCA[.]" Persons party to Docket No. D99.12.277 are either those identified in

or responding to the Commission's December 21, 1999 Notice.<sup>1</sup> Qwest's filing to deaverage network element prices in any interconnection agreement covered by § 69-3-848(4), MCA, will be considered in Docket No. D96.11.200, the Qwest/AT&T arbitration docket. The parties to Docket No. D96.11.200 are Qwest, AT&T and the Montana Consumer Counsel.

Therefore, in the Amended Notice the Commission established two dockets to respond to the FCC's deaveraging rule. Docket No. D99.12.277 addresses deaveraging for all network element prices save for those prices established in the Qwest/AT&T interconnection agreement. Deaveraging for network element prices in the Qwest/AT&T interconnection agreement is addressed under Docket No. D96.11.200. Qwest made a filing in each docket, and each docket has proceeded on the same schedule.

A hearing was held on these dockets on June 7, 2000. Post hearing briefs were submitted by Qwest (initial and reply), AT&T (initial and reply), Montana Wireless (initial and reply), and the Montana Consumer Counsel (initial only). Briefing was completed on August 15, 2000.

### **Legal Issue**

As it attempts to comply with the FCC deaveraging rule the Commission, as noted, must also consider Montana law on the same subject. Section 69-3-848, MCA, reads in relevant part as follows:

(1) ...

(a) ...

(b) ...

(c) ...

(d) ...

(2) ...

(3) If a telecommunications carrier uses average prices for services to end users without regard to the customer's location, the commission shall similarly establish an average cost and wholesale price for each individual network element sold to other telecommunications carriers. The commission may depart from average pricing for network

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<sup>1</sup> Parties to Docket No. D99.12.277 are the Montana Consumer Counsel, Telecommunications Resellers Association, AT&T Communications of the Mountain States, Ronan Telephone Company, Montana Communications, Touch America, Western CLEC Corporation (formerly Eclipse), Montana Telecommunications Association, Skyland Technologies, Montana Wireless, and Net Edge Networks.

elements only to the extent that the retail prices to end users of a telecommunications carrier have departed from average pricing.

(4) This section does not apply to the prices, terms, and conditions of a final or interim arbitrated interconnection agreement, arbitration decision, or appeal from an agreement or decision if the request for arbitration was filed on or before March 1, 1997.

Qwest argues that its filing in Docket No. D99.12.277 is "a correct application of 47 C.F.R. § 51.507(f), which also complies with [§ 848(3)]." Qwest opening brief, p. 5. Qwest contends: 1) The Telecommunications Act does not expressly preempt § 848(3); 2) Federal law is not "so pervasive," and does not occupy the field such that states cannot pass laws pertaining to deaveraging; 3) There is not a conflict between the two laws – 47 C.F.R. § 51.507(f) and § 848(3) – such that they cannot be reconciled. Qwest writes, "Section 69-3-848(3) in no way prohibits the Commission from geographically deaveraging unbundled network elements. All it does is require the Commission to use a consistent deaveraging methodology across both wholesale and retail rates." Qwest opening brief, pp. 10-11.

AT&T contends that § 848(3) is preempted by federal law "[b]ecause it is impossible here to comply both with Section 69-3-848(3) regarding deaveraged wholesale rates and controlling federal law." AT&T reply brief, p. 4. AT&T disagrees that the Qwest proposal satisfies both federal and state law. MWI supports AT&T on this issue, arguing that the Qwest proposal violates federal law because it "proposes to establish its deaveraged loop rates based on its retail zone pricing, not on the actual cost of providing the loop within the particular zone." MWI opening brief, p. 5. MWI maintains that the Act requires that Qwest's UNE prices must be based on cost. MWI asserts that FCC rules "have preempted the field of local competition regulation, including the aspects of geographic deaveraging." *Id.*, p. 8. Therefore, MWI concludes that § 848(3) is clearly preempted and the Commission has no option but to reject the Qwest deaveraging proposal.

Qwest responds to AT&T and MWI by arguing that 47 C.F.R. § 51.507(f) "does not prescribe any particular methodology," but requires only that "different prices in three geographically defined areas" must be based on a cost related plan pursuant to state law.

Qwest reply brief, p. 2. "As long as its deaveraging plan is 'cost related,' the design of that plan is vested within the soundly exercised discretion of the State of Montana." Id. On this basis Qwest concludes that federal law is flexible enough to allow a deaveraging proposal that harmonizes federal and state law – a proposal that Qwest contends it has made.

AT&T and MWI also argue that the Commission need not reach the preemption issue because § 69-3-848(3), MCA, does not apply to this case. They contend that § 848(4) means that any constraint imposed by § 848(3) does not apply to AT&T, but that "[m]oreover, the Commission need not follow [§ 848(3)] with regard to any other competing local exchange carrier's ("CLEC's") loop rates in Montana because Qwest requires all other CLEC's to adopt the rates set in the AT&T/U S West (Qwest) arbitration." AT&T reply brief, p. 2. In other words, AT&T and MWI argue that because all CLEC/Qwest UNE rates are established in Montana with reference to the Qwest/AT&T interconnection agreement, and UNE rates can be established in that agreement unconstrained by § 848(3), then it is not necessary for the Commission to address § 848(3) when deaveraging pursuant to federal law.

#### Legal Discussion

The Commission finds that § 69-3-848(4), MCA, is plain on its face. "This section" refers, and can only refer to § 69-3-848, MCA.<sup>2</sup> Therefore, whatever section 848, and all its subsections, requires does not apply to those specific things identified at 848(4).<sup>3</sup> For purposes of these dockets the relevant subsection is § 848(3). Whatever constraints are imposed on the Commission by § 848(3) as it attempts to comply with the FCC deaveraging rule, do not apply to anything covered by § 848(4).

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<sup>2</sup> The Montana Code is divided into titles, chapters, parts, sections and subsections. The citation "69-3-848, MCA" refers to Title 69, Chapter 3, Part 8, Section 848 of the Montana Code.

<sup>3</sup> This does not mean that the Commission could not be guided by other subparts of section 848 as they apply "to the prices, terms, and conditions of a final or interim arbitrated interconnection agreement, arbitration decision, or appeal from an agreement or decision if the request for arbitration was filed on or before March 1, 1997."

With reference to Docket No. D99.12.277, § 69-3-848(3), MCA, clearly limits the Commission as it attempts to comply with 47 C.F.R. § 51.507(f). Absent § 848(3) the Commission would be free to deaverage with reference only to federal law and party advocacy. But with § 848(3), assuming it is lawful, the Commission can deaverage wholesale prices for unbundled network elements "only to the extent that the retail prices to end users of a telecommunication carrier have departed from average pricing." The parties to these dockets disagree over whether § 848(3) constrains the Commission as it attempts to comply with 47 C.F.R. § 51.507(f), or whether § 848(3) is preempted by federal law and may be ignored.

The Commission generally agrees with Qwest that it is not the proper function of an administrative agency to determine the constitutionality of its own enabling legislation. The one exception would be, as the Commission noted in its Amended Notice, if "there is absolutely no good faith argument to support Montana law." Therefore, the Commission's role here is not to weigh all the arguments and case law and issue an opinion on the preemption challenge, as a court would do. Rather, the Commission must simply determine whether there is a good faith defense to the preemption challenge.

Obviously, AT&T and MWI have an extremely heavy burden to convince the Commission that there is "absolutely no good faith argument" in response to their preemption challenge. They would, in effect, have to persuade the Commission that Qwest's defense is frivolous. After reviewing the preemption arguments, the Commission cannot conclude that there is no good faith argument in support of § 848(3). Therefore, as the Commission has indicated, federal and state law must be harmonized in Docket No. D99.12.277.

Finally, regarding the AT&T and MWI argument that the Commission need not concern itself with § 69-3-848(3), MCA, because all Qwest/CLEC loop rates in Montana are controlled by the Qwest/AT&T interconnection agreement, the Commission finds that the purpose of this proceeding is to deaverage Qwest UNE rates in a manner consistent with state and federal law. As discussed, this requires that the Commission address UNE deaveraging as it applies 1) to Qwest and all CLECs other than AT&T, and 2) to Qwest and AT&T. The legal effect of deaveraging on UNE rates established in Qwest/CLEC

interconnection agreements, other than the Qwest/AT&T interconnection agreement, is not before the Commission in these dockets.

### Direct Testimony

Qwest's witness Robert Brigham filed direct testimony in both dockets. His direct testimony describes Qwest's proposal to deaverage the unbundled element for the loop (loop UNE hereafter). He explains why his proposal complies with 47 C.F.R. § 51.507(f) and why it is also consistent with the Commission's February 1, 2000 Amended Notice.

Mr. Brigham's direct testimony has two main sections. One section includes his general comments and the next section describes Qwest's actual rate deaveraging proposal. His general comments are in three parts. First, he explains the FCC's and the Commission's deaveraging requirements. Second, he explains why only the loop UNE needs to be deaveraged. Third, he explains what consistency needs to exist between retail and wholesale rates.

Mr. Brigham first explains how the FCC's deaveraging rules were promulgated and the requirements they place on state commissions. Next he explains why the loop UNE is the only UNE that needs to be deaveraged at this time. His proposal is premised on evidence that costs vary between geographic areas in relation to loop length and density. He concludes that the cost for other UNEs, such as switching, do not feature significant geographic cost differences. He adds that another element, transport, is already deaveraged based on distance. If costs do not vary geographically, then there is no meaningful basis to deaverage.

The majority of Mr. Brigham's general comments are directed at explaining why the wholesale loop UNE must be deaveraged consistent with how retail rates are deaveraged. He elaborates on the consequences of not maintaining such consistency. He asserts that it would be discriminatory, and not competitively neutral, to require Qwest to deaverage wholesale rates inconsistently with how retail rates are deaveraged.

Mr. Brigham describes the retail rate structures to which the deaveraged wholesale loop UNEs must conform. The basic residential and business rates are \$16.73 and \$34.21 respectively. However, adders may apply outside of base rate areas. The four types of adders include Zone Increment Charges ranging from \$.75 (zone #1) to \$5.75 (zone #3); Suburban and Locality Rate Area charges (\$.25 in zone #1 and \$.75 in other zones); and, an extended area

service (EAS) increment of \$2.44 in certain extended service areas. Exclusive of the EAS charge residential rates range between \$16.73 and \$22.48 per month. Similarly, the basic business rates range from \$34.21 to \$39.96 per month. The "spread" between the lowest and the highest rates is \$5.75. Although there are five separate retail rates per class, Mr. Brigham combines two rates for each class and, in turn, refers to the four current retail rates in his testimony.

Mr. Brigham next explains the negative consequences that would occur if wholesale rates were deaveraged in a manner that is inconsistent with retail rates. His main concern is deaveraging wholesale rates beyond the level of deaveraging that exists with retail rates. He adds that further deaveraging of the current retail four-zone structure is not consistent with the competitive environment envisioned by the 1996 Act.

He explains that presently urban low-cost retail customers (residential and especially business) pay retail prices that exceed the cost of service. The difference is a subsidy that accrues to rural high-cost retail (business and residential) customers. Because of rate deaveraging, in combination with rate-cost differences, a majority of the competition Qwest faces is in urban business areas, and not in rural areas. Due to the averaging of retail rates and because retail rates exceed costs, further deaveraging beyond the \$5.75 "spread" would exacerbate the "margin" opportunities that exist for competitive carriers to exploit. Brigham predicts that competitors "would continue to flock to urban areas." Absent simultaneous and consistent deaveraging with retail rates, further deaveraging of wholesale rates creates "very unequal" competitive choices for Montana consumers.

Mr. Brigham also explains that further deaveraging is not competitively neutral. He testifies that if UNE rates are deaveraged to a greater extent than retail rates, one result will be increased prices in rural areas. Retail and wholesale prices must be "synchronized." If deaveraging is to work in a competitively neutral manner, competitors must purchase UNEs in all deaveraged areas so that the aggregate revenue Qwest derives from the sale of deaveraged UNEs is the same as the aggregate revenue that derives from a state-wide average price. If, for example, UNE prices are raised in rural areas while retail rates are unchanged, and since deaveraged UNEs priced below the average will only be purchased, a consequence is that aggregate UNE revenue will not be equal before and after deaveraging. In turn, Qwest will be unable to recover its costs -- an outcome that is not consistent with The 1996 Act. Consistent

deaveraging of "retail rates and rates for underlying UNEs" avoids this non-competitively neutral outcome.

Also, because competitors can use deaveraged UNEs to undercut (arbitrage) the basic business rate, Brigham indicates that UNE deaveraging beyond the level of retail service reduces the subsidy for high cost areas. This is a threat to Qwest's financial viability. Although implicit subsidies will erode over time due to competition, he asserts that excessive deaveraging speeds the process. As implicit subsidies disappear explicit subsidies must substitute, or rate increases must occur in high-cost areas. He testifies that Qwest could be left providing retail service to high-cost customers that are now subsidized and wholesale service via UNEs and without any subsidy to customers in low-cost areas. In this scenario, Qwest's choices include reducing basic exchange retail rates for businesses or do nothing and lose the customers that provides implicit support in the business rates. In either case the implicit support disappears.

Mr. Brigham concludes this part of his testimony with two observations. Any attempt to further deaverage wholesale rates should contemplate long-term revisions to the retail rate structure. Because deaveraging causes rate increases in high-cost areas, further deaveraging must be orchestrated with the resolution of universal service issues.

Mr. Brigham next explains the deaveraging plan he believes the Commission should approve. He lists additional criteria the Commission should consider when it adopts a rate deaveraging proposal: The adopted proposal must be effectively communicated to customers and easily understand. The proposal must allow customers to be easily assigned to "deaveraged groups" (zones we assume) for billing purposes. The proposal should provide consistent rates for customers in similar geographic areas and rate arbitrage opportunities should be minimized if not eliminated. Consistent with the existing retail rate structure in Montana, Qwest's proposal would deaverage the loop UNE into four zones (rates). Mr. Brigham testifies that this proposal is consistent with the above noted criteria and adds that a similar deaveraging plan was adopted in Colorado and Wyoming.

Qwest's proposal involves several detailed steps that result in separate loop UNE rates for each of four zones (1) \$26.69 in the base rate area; (2) \$27.62 in zone #1; (3) \$31.36 in zone # 2; and (4) \$33.85 in zone #3. Mr. Brigham admits that Qwest's wholesale rates will not equal cost, but he testifies that they are cost based. In defense of his deaveraging proposed, he notes that

FCC rule . 51.507(f) does not require UNE rates to be set equal to cost, a requirement that can not be met unless there is a separate loop UNE for each retail customer. He asserts that Qwest's density-related zone pricing complies with FCC rules because it offers lower priced loop UNEs in lower cost zones, and higher priced loop UNEs in higher cost zones. The detailed steps include: 1) compute the retail rate in each zone for each class (residential and business); 2) compute the weighted-average rate in each zone for both classes (weights are the percentages of residential and business loops in each zone); 3) using the percentage of loops in each zone compute a single weighted average retail rate of \$22.01; and 4) use the weighted average rate in each zone in relation to the single weighted average retail rate to compute percentages for each zone that, when multiplied times the existing single loop UNE rate of \$27.41, results in a separate loop UNE rate for each zone.

Douglas Denney testified for AT&T. He states that the unbundled loop is the most important element to deaverage. The determination of whether a UNE should be deaveraged should be based on (a) the existence of significant cost differences in providing the UNEs in different geographic areas; and (b) the ability to appropriately distinguish these cost differences. He states that it does not make sense to deaverage rates where significant cost differences do not exist.

Mr. Denney recommends that the Commission establish three cost-based zones. These zones should be determined by grouping together wire centers with similar costs. In selecting a methodology for deaveraging, the Commission should be mindful of the cost that complicated methodologies could impose on both CLECs and ILECs. He believes that the Commission should select a methodology that is simple and does not impose unnecessary implementation costs.

Mr. Denney explains that there are two problems with Qwest's approach to using retail rates as the basis for the wholesale rate proposal. First, this approach to deaverage has no economic basis, is backward, and anti-competitive. Second, though Qwest claims to have used deaveraged retail rates as the basis for its proposal, Qwest has deviated significantly from the retail structure in place in Montana.

Mr. Denney explains that the purpose of deaveraging wholesale rates is to facilitate efficient competition by allowing the price of unbundled network elements to more closely

represent their underlying cost. Prices that are not based on cost will send the wrong signal to the market and he believes may encourage inefficient entry, or discourage entry by an efficient competitor. Although Qwest claims to base its deaveraging proposal on the current retail rate structure he asserts, however, that this is in complete contrast to the purpose of deaveraging and the method by which markets function. He states wholesale costs are not a function of retail revenue.

Mr. Denney contends that Qwest's proposed loop deaveraging comprised of four zones, ranging in price from \$26.69 to \$33.85 does not reflect the current divergence in retail rates that exist in Montana, and further does not attempt to reflect differences between the total retail revenue available within each cost-based zone.

Mr. Denney asserts that Qwest's deaveraged loop rates proposal is not based on cost. He explains that Qwest does not utilize cost estimates specific to the geographic areas for which it proposes deaveraged rate. Qwest makes no attempt to determine the forward-looking cost in this area. He contends that Qwest uses the current spread between a subset of the retail rates to allocate the interim loop price of \$24.79 between a subset of the retail zones.

Mr. Denney explains that Qwest's proposal gives it competitive advantages in low-cost areas, due to it setting the low-cost areas well above cost. By doing this, Qwest has a cost advantage in low-cost areas, where most of the customers in the state reside. He also contends that the Qwest's proposed zones are not based on clear and easily defined geographic boundaries, and a CLEC will have a difficult time determining a potential customer's zone without going through Qwest's OSS System. Mr. Denney believes that Qwest will want to collect a charge from CLECs for all database queries.

Mr. Denney concludes that three zones should be sufficient at this time, although AT&T does not oppose the creation of more than three cost-based zones. However, AT&T does not oppose Qwest's four deaveraged zones because they are not based on cost, are calculated below the wire center and reflect almost no deaveraging in the state of Montana.

While there is a variety of different methodologies for defining zones for deaveraging, Mr. Denney contends that the most practical way to deaverage is to combine areas with similar costs into at least three cost-based zones. He contends that utilizing zones based on cost

differences between wire centers is the most appropriate method to begin the deaveraging process, since each loop is uniquely assigned to a wire center.

In conclusion, Mr. Denney states the Commission should determine the unbundled loop cost by wire center. Since the Commission has ordered a \$27.41 interim unbundled loop rate in Montana, the results from the cost model selected should be scaled to maintain the Commission's statewide average rate. In response to PSC Data request PSC-021 (b), Mr. Denney explains the scaling factor is calculated by dividing the statewide average ordered rate by the cost model result. This factor is then multiplied by each wire center cost in the model so that the cost model scaled result match the statewide average ordered rate. Mr. Denney relied on the HAI Model, version 5.0a, to determine relative costs by wire center. Next, Mr. Denney stated that the data should be sorted by cost so that wire centers can be grouped according to similarities in cost into the wire center cost-based zones. The resulting loop UNE rates for the three zones are: (1) \$15.89 in zone one; (2) \$21.23 in zone two; and (3) \$54.10 in zone three.

The Montana Consumer Counsel, through witness Alan Buckalew, supports Qwest's proposal. Mr. Buckalew contends that there should not be any other UNE rates deaveraged at this time, because there does not appear to be any major cost difference that would suggest that deaveraging is appropriate for switching. Mr. Buckalew stated that Qwest's proposal satisfies the requirement of the FCC without causing changes to the retail consumer rates charged by Qwest.

Mr. Buckalew explains that deaveraging the rates as Qwest has proposed would slow the development of competition in the areas outside the base rate area. Moving deaverage UNE rates to cost would likely cause competition to concentrate in the major metropolitan areas. However, Mr. Buckalew asserts that approving Qwest's zone-based proposal will cause the least disruption in retail rates. He concludes that if the Commission determines that Qwest's proposal is not sufficient or appropriate, Qwest should be ordered to produce a current TELRIC study on the zone based proposal.

MWI witness Joan Mandeville agrees with Qwest that only the loop needs to be deaveraged at this time and this is where the primary focus should be.

Ms. Mandeville proposes an adjustment to the interim rates currently in affect in Montana by deaveraging that rate into 3 zones using either the HAI model 5.0a or the Hybrid Cost Proxy

Model (HCPM). Ms. Mandeville contends that the HAI model is probably more suited to calculating the cost of unbundled network elements. However, the HCPM model has been more thoroughly vetted during FCC proceedings. She states that because the HCPM model was only intended to calculate universal service support, it has flaws for calculating element specific prices. Ms. Mandeville states that the default cost run for HCPM results in an overall loop cost of \$26.64, fairly close to the current Montana rate. The average HAI cost is \$18.02.

Ms. Mandeville contends that that one significant problem in deaveraging between the exchange levels is the administrative problem of identifying the existing customers based to the zone used. She states that Qwest needs a reasonable approach that is not cost-prohibitive to implement, while competitors need an approach where they can determine the cost of serving customers and verify the bills they are receiving for unbundled loops. To solve these problems Ms. Mandeville suggested using US West's current retail zone structure to deaverage rates.

Ms. Mandeville contends that Qwest's retail zones do not match the density zones in the cost proxy model. MWI is only proposing to use the model results to estimate the relative costs of each area and then apply the results to the current interim rate. In calculating these estimates, she stated MWI used very conservative assumptions that tended to minimize the impacts of deaveraging. Ms. Mandeville also stated that MWI's proposal deducts Qwest's universal service payments from the most costly zone, thus lessening the impact of deaveraging.

In Qwest data request USWC-38 Ms. Mandeville explains that she relied on the relative line counts used by Qwest's Brigham to determine the different zones. Zone 1 contains the densest portion of Qwest's service territory and Zone 3 contains the least dense portion of its service territory. She then reviews the line counts Qwest reported in its exhibits and those produced by the HAI and HCPM model to get the overall percentage of lines by retail zone and by model density zone to be approximately the same.

Ms. Mandeville states that the result of MWI's proposal using the HCPM to assign costs to zones and deaveraged loop rate are as follows: (1) \$16.64 in the base rate area; (2) \$47.58 in zone one and two; and (3) \$173.81 in zone three. If the HAI model is used to assign costs to zones the deaveraged loop rates are as follows: (1) \$14.40 in the base rate area; (2) \$44.36 in zone one and two; and (3) \$246.52 in zone three.

Mr. Brigham's rebuttal testimony defends Qwest's deaveraging proposal and challenges the proposals of some intervenors.

Qwest's rebuttal makes the following points. First, Mr. Brigham testifies that AT&T is wrong to state that Qwest's consideration of retail rate structure violates economic theory. On the contrary, economic efficiency is achieved by ensuring that wholesale rates are consistent with retail rates. Further, § 69-3-848(3) MCA recognizes the need for consistency between wholesale and retail rate structures, something lacking in AT&T's own proposal. Second, Mr. Brigham finds meritless AT&T's arguments that wholesale costs are not a function of retail revenue and that retail revenue is not an issue in this case. Retail prices, not total revenue by wire center, are needed to assure consistency. He adds that Qwest has not argued that loop UNE rates must match total retail revenue per line. Third, Mr. Brigham rebuts AT&T's claim that Qwest's deaveraging proposal is not cost based. Mr. Brigham asserts that AT&T misstates the FCC requirement for cost-based pricing. The FCC, Qwest asserts, does not require that the rate equal cost. Rather, the FCC requires only that there be at least three geographic "cost-related" zones. Because Qwest proposes higher loop UNE rates the further a zone is from the central office, Qwest's approach is in compliance. In this regard, Mr. Brigham cites to a 1981 Commission order that established base rate area zones. He testifies that because the Commission set zone rates to reflect the cost of loops outside the base rate area, that "rates" based on this zone increment rate structure are "cost related." Fourth, Mr. Brigham rebuts AT&T's allegation that Qwest's proposal seeks to limit competition in urban areas. Qwest admits its rates (loop UNE and basic exchange business) may be above cost, an admission that follows Qwest's unique "obligation". By contrast, Mr. Brigham testifies that it is AT&T's plan that discourages competition, albeit in rural areas. He concludes that Qwest's plan does not confer competitive advantages on Qwest in urban areas. Given the extent of competition that is occurring in urban areas AT&T's argument that competition cannot emerge absent significant deaveraging lacks support. Fifth, rebutting AT&T's allegation that Qwest will want to collect charges for database queries, Brigham claims: 1) that AT&T's claim has no basis; 2) that just as OSS information is available, customer zone information is available from records; and 3) that there is no added cost to locate customers in new zones with Qwest's proposal. Moreover, Brigham asserts that Qwest's deaveraging proposal will not make it difficult for CLECs to determine the appropriate UNE cost

for potential customers, as claimed by AT&T, and that with Qwest's proposal there is no added cost to locate customers.

Qwest also rebuts AT&T's loop UNE deaveraging proposal. First, Mr. Brigham rebuts AT&T's assertion that the FCC requires the deaveraging approach that AT&T used. Qwest contends that nothing in the FCC's rules or its First Interconnection Order requires an AT&T like plan, or precludes a Qwest like plan. In short, the FCC merely requires a density related or other cost-related zone-pricing plan. The FCC does not prescribe a "best way". Nowhere does the FCC require a deaveraging approach that merely aggregates wire centers into zones based on average costs. Second, Mr. Brigham finds that AT&T's approach arbitrarily groups wire centers and thus distorts average prices. With AT&T's approach customers will still pay rates that are far below or above cost. Mr. Brigham claims that AT&T's proposal must be rejected for not complying with Montana law. Finally, Mr. Brigham testifies that the AT&T cost model, the HAI, has a significant number of flaws and therefore does not accurately calculate loop costs. As evidence of the distortion in AT&T's deaveraging proposal, Mr. Brigham provides the following data:

<u>Zone</u>	<u>Number of Wire CTRs</u>	<u>Low Cost</u>	<u>High Cost</u>	<u>Cost Range</u>	<u>Loop Rate</u>
1	7	\$14.56	\$17.74	\$3.18	\$15.89
2	6	\$19.89	\$22.17	\$2.28	\$21.26
3	59	\$26.56	\$551	\$524	\$54.93

From these data he concludes that wide variation exists in the cost for wire centers using AT&T's proposed deaveraging. Also, there is nothing objective or scientific about how AT&T groups costs. This type of manipulation by AT&T illustrates what can occur when deaveraging uses a "sort by cost" method.

Mr. Brigham asserts that Qwest has not deaveraged basic service in Montana beyond the current geographic zones, and adds that Qwest has limited authority to do so. Because Qwest has only limited ability to further deaverage retail rates and no ability to do so for residential, he argues that it is incorrect that Qwest's retail rates are deaveraged beyond current zones or that they can be deaveraged beyond current zones.

Mr. Brigham rebuts MWI's reasoning that because of the current loop UNE rate, CLECs cannot profit from offering basic residential exchange service. He contends that MWI does not consider all revenue that a CLEC can collect. Whereas MWI includes basic exchange, subscriber line, switched access and carrier common line charge revenue sources, Mr. Brigham asserts that MWI ignores revenue from central office features and intraLATA long distance. As a result, MWI's revenue estimate of \$28.74 is low compared to Brigham's estimates of \$40/residential line or \$75/business line. Therefore, even though Qwest's proposal prices the basic residential exchange rate below the deaveraged loop UNE price (and cost), there is significant "margin" available to CLECs. Because residential service is priced below cost, Mr. Brigham concludes Qwest has no competitive advantage.

Mr. Brigham disputes MWI's testimony that suggests loop costs must be below a competitor's total cost. Mr. Brigham adds that there is no requirement or any economic basis for pricing an unbundled loop UNE price "significantly below" a CLEC's cost to build the same loop. Loop UNE prices should be based on "forward-looking TELRIC (plus common)", a cost that should approximate the cost of an efficient entrant that has similar scale economies. The "implicit support" that Qwest could lose depends on whether a competitor takes a customer via its own facilities or via a loop UNE. If a competitor captures a Qwest "retail business customer" with its own facilities, Qwest loses "implicit support". If a competitor serves a customer by means of a loop UNE, Qwest "loses the implicit support", but recovers the "cost" of the loop if the loop price equals cost. Qwest, however, does not believe loop UNE prices cover cost.

Mr. Brigham challenges MWI's assertion that Qwest will rebuild copper facilities around carrier systems when a competitor requests a loop UNE that reaches 18,000 feet beyond the central office. MWI contends the longer loops provide degraded service. Mr. Brigham says this is incorrect. Qwest does not rebuild copper facilities to provide "basic" loop UNEs. If a longer loop is provided over a carrier system, the same carrier-based loop is used to provide a loop UNE to the CLEC.

Mr. Brigham also rebuts MWI's position on DSL services. MWI states that data CLECs cannot compete with Qwest's Megabit service unless loop UNE prices are deaveraged such that significant rate reductions result. Mr. Brigham finds this testimony irrelevant and confusing. He interprets MWI to make two arguments. One argument is that CLECs will not provide DSL

service to customers with longer loops (over 18,000 feet). The second is that it is very important that loop UNE rates to data CLECs not be based on the average cost of a loop that includes the cost of longer loops, a situation MWI concludes is anticompetitive.

Mr. Brigham argues that because data CLECs can subscribe to line sharing, they need not purchase an entire loop at \$27.41 to provide DSL service. He adds that if Qwest is not the customer's voice service provider, the CLEC can line share with the other provider. He adds that Qwest's DSL uses line sharing technology. He finds nothing anticompetitive about Qwest's proposal.

Mr. Brigham rebuts MWI's deaveraging proposal. He claims MWI's plan is illegal and suffers from conceptual and mechanical problems. Mr. Brigham describes the MWI proposal as one that involves deaveraging loops into three geographic zones using either the HAI or the FCC's HCPM (Hybrid Cost Proxy Model or Synthesis Model). The geographic zones are the current Qwest retail rate zones, collapsed into three rather than four zones.

Mr. Brigham testifies first that the MWI's proposal violates Montana law. Second, he asserts that the major problem with the MWI proposal is the HCPM's mapping routine. Because the HCPM's density zones are not similar to Qwest's retail rate zones, MWI had to map the HCPM zones to Qwest retail rate zones. In so doing, and as an example, MWI mapped HCPM zones 4 through 9 (that contain 81 percent of the loops) into the retail rate zone known as the "base rate area" (that contains 78 percent of loops). Brigham identifies this as a major problem because MWI assumes that the loops are the same. Absent any support or evidence of correlation, Mr. Brigham concludes this problem renders the MWI proposal unusable.

Another problem Mr. Brigham has with MWI's deaveraging proposal is how it applies federal universal service payments to the cost of loop UNEs. MWI applies such payments to the cost of their loop UNE for zone three. He holds that MWI's proposal violates FCC rules as only eligible telecommunications carriers (ETCs) may receive such funding. ETCs must meet certain basic service and other criteria to receive such funds. He concludes that MWI's proposal violates The 1996 Act because it provides funding to carriers not certified as ETCs.

AT&T also challenges the MWI proposal. Mr. Denney stated that the problem with MWI's proposal is that it places too many customers in one zone; as a result the degree of deaveraging is less. Currently he contends that 80 percent of Montana's customers live in the

base rate area. Costs vary significantly between the base rate areas in different wire centers. Grouping a large number of customers into one zone increases the degree of averaging taking place in that zone, and thus limits the amount of deaveraging that is taking place in the state.

Mr. Denney explains that there is a problem with using Qwest's current retail zones for the loop deaveraged zones. He states the purpose of deaveraging is to facilitate efficient competition by creating deaveraged wholesale prices that more closely reflect their underlying cost. He contends the determination of deaveraged loop rates should not be based upon Qwest's retail zone structure, which he notes was established in the 1950's. The cost of providing UNEs in different areas of the state should be a major consideration in setting UNE rates.

Another concern AT&T has with MWI's proposal is the use of the HAI and FCC synthesis model. He contends that the FCC Synthesis Model does not explicitly estimate loop cost, and density zones do not easily match up with Qwest's current retail zone design. He explains that the FCC Synthesis Model was not developed to estimate the cost of the unbundled loop even though appropriate loop investments are contained in the model.

Mr. Denney explains that MWI determined the cost model loop estimates by density zone and then allocated the density zone to deaveraged zones based on the percentage of lines occurring in each. He explains that density zone costs are determined by aggregating cluster costs for all clusters that fall within a prescribed zone range, but the density does not determine the location of clusters within a wire center. Thus, he asserts that the assignment of density zones to the base rate area will not result in the most precise estimate of costs for these areas.

In conclusion Mr. Denney reasserts AT & T's position of deaveraging rates in Montana by defining cost-based zones by grouping together wire centers with similar costs. However, if the Commission were inclined to link UNE deaveraged zone with the current retail rate structure, then MWI's proposal is superior to the non-cost based approach offered by Qwest. Mr. Denney recommends that if the Commission is inclined to use MWI's approach it should recalculate the loop cost estimate by clusters and assign clusters to the retail rate zones on a wire center basis, rather than by density zone.

### Commission Decision

Based on the options presented by this record, the Commission adopts the deaveraging proposal submitted by Qwest for both dockets. The reasons are as follows: First, the other cost options were not critically debated and analyzed. There was some effort by each party to set its own proposal apart from others. But, by diminishing the quality of other options, it does not necessarily follow that the remaining option is preferable. The Commission finds that a robust analysis and debate of the merits and demerits of the various loop UNE deaveraging options did not occur in this docket. Therefore, the Commission is guided in its decision by the principle of rate stability.

Although normally applied to retail pricing, the concern for rate stability applies also to wholesale market rates. It would be a disservice to the CLEC industry and its customers to pick a cost option today and then select an entirely different option in the ongoing permanent pricing docket (D2000.6.89). For example, if either MWI's or AT&T's proposal were adopted now, but a more accurate proposal were adopted as a result of the permanent pricing docket, the result could be wildly varying deaveraged loop UNE rates over the span of one year. The Commission notes as well that MCC expressed concern for retail price stability for Qwest's remaining retail customers.

Although the Commission adopts Qwest's rate/revenue deaveraging proposal here, this could change in a future docket. There is reason to believe that Qwest's rate/revenue deaveraging proposal, although arguably related to costs, is arbitrary. The Commission adopts it because it will not create a large variation in unbundled loop rates before the Commission determines a permanent loop UNE rate in Docket No. D2000.6.89.

### Conclusions of Law

1. The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. Qwest is a public utility offering regulated telecommunications services in the State of Montana. Section 69-3-101, MCA.

2. The Commission has authority to do all things necessary and convenient in the exercise of powers granted to it by the Montana Legislature and to regulate the mode and manner

of all investigations and hearings of public utilities and other parties before it. Section 69-3-103, MCA.

3. Adequate public notice and an opportunity to be heard has been provided to all interested parties in this Docket, as required by the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA

4. Pursuant to 47 C.F.R. § 51.507(f), the Commission is required to "establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences."

5. When complying with 47 C.F.R. § 51.507(f), the Commission must also comply with § 69-3-848(3), MCA.

6. For entities to which § 69-3-848(4), MCA, applies, the Commission may comply with 47 C.F.R. § 51.507(f) without regard to § 69-3-848(3), MCA.

7. There is a good faith argument that § 69-3-848(3), MCA, is not preempted by federal law and, thus, § 69-3-848(3), MCA, is presumptively valid.

8. The Commission presumes that Qwest's deaveraging proposal is consistent with both federal and state law.

#### Order

The Commission approves Qwest's deaveraging proposal in these dockets. Qwest is directed to make a compliance filing changing rates in its AT&T interconnection agreement consistent with this order.

DONE AND DATED this 12th day of December, 2000, by a vote of 4 to 1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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DAVE FISHER, Chair

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NANCY MCCAFFREE, Vice Chair

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BOB ANDERSON, Commissioner

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GARY FELAND, Commissioner

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BOB ROWE, Commissioner, Dissenting

ATTEST:

Kathlene M. Anderson  
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.